DOW THEORY LETTERS INC.

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THE PICTURE: I've never seen anything exactly like it. Almost every advisory service I've read over the past month has been talking something like this: "Seventy-five percent of the other market letters we read are bullish, and since 'too much bullishness' is a danger signal, we're cautious to bearish on the immediate Wall Street outlook." Suddenly, the hottest indicator in town is the bullish-bearish count of the advisories. Consequently, all the market services have been counting each other's noses and coming out with negative readings.

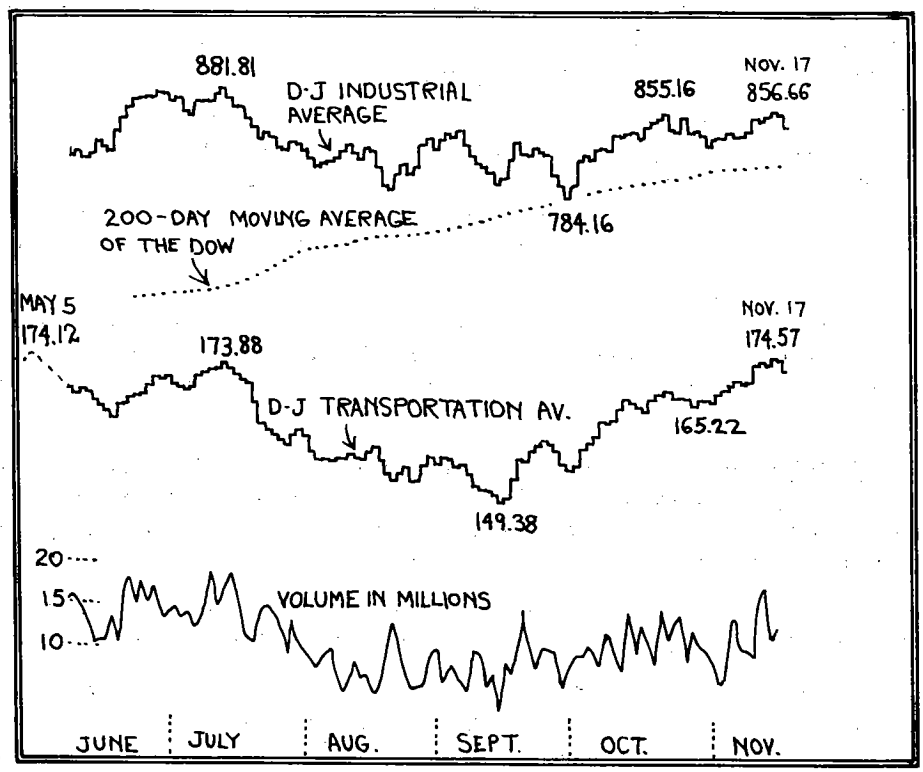
My response to all this is that when a "contrary opinion" becomes common knowledge, it is not a contrary opinion any longer. Personally, I believe that the bullish-bearish count of the advisory services has received far too much publicity of late. For this reason, I have distrusted it.

Furthermore, most of today's market writers and analysts have been operating for most of their working lives within the context of a primary bear market (i. e., 1966 to 1974). They have not had bull market experience. In a bear market, you can have a lot of bears around, and the market can still collapse. In other words, the bears can be right for long periods of time, since they are in harmony with the primary trend. The same is true during a primary bull market. There are times when "almost everyone" is bullish during a bull market, and the market, nevertheless, continues to rise. In other words, a primary bull market can absorb a good deal of optimism and still continue to climb.

It's really rather strange, but I have the feeling that nobody seems to like this primary bull market at all. Analysts, fund managers, investors, the public, they just don't seem to like it. You might even say that they resent it. It could be that the nation is so used to bad news at this point (and Lord knows we've had our share of it over the past few years) that nobody's ready for anything good — not even a good old primary bull market!

It all reminds me very much of the year 1958, the year I started Dow Theory Letters. I had turned extremely bullish, following the searing market drop of 1957. The Averages hit bottom in October of 1957, then turned cautiously higher. A severe recession hit the economy during 1958, even while the Averages were plowing upward. The public and the Wall Street fraternity turned increasingly bearish as the market advanced, and talk of an "all out crash" became commonplace as did comments such as "the market has lost its mind," and "Wall Street is on a suicide path." I had never seen so many people actually resent a bull market, and of course the reasons were obvious. The newspapers and the media were emphasizing the fact that a severe recession was in progress, and the nation was bearish almost to a man.

Thus, the public and the majority of investors were positioned according to their emotions, and that means they were out of stocks. Now no one hates a bull market that is holding (consolidating) or climbing in the face of economic uncertainties more than a man who is out of the market. He's the same man who "knows" that Wall Street is rigged, that the market is "insane," that the "interests" are running the market up.



Today, as the market backs, fills, bounces and pushes higher, I believe we have much the same technical and psychological situation that we witnessed back in 1958. This bull market is unpopular and it's resented — mainly because so few people are positioned to make a nickel out of it. In a phrase, the public is out of Wall Street.

I've repeated this theme in almost every mailing since late-December, but I'll say it again — this is a primary bull mar-

ket. One factor about a bull market that most people do not comprehend is that during a primary bull trend, time favors higher prices. In other words (and this is crucially important to understand), time during a bull market favors the bulls.

The lows for the current secondary correction occurred in September and October for the Averages (784.16 for Industrials, 149.38 for Transports). Two months have elapsed since the Transport lows, and neither Average has broken to new lows. Actually, according to Dow Theory, both Averages would have to break to new lows to reconfirm the secondary downtrend. My feeling is that with all the bad news since September, with threats of NYC folding, the banks going under, the economy sagging, with all of that bearishness emerging — time has about run out for the bears.

"But how about reversing that statement," you retort, "how about saying that the last recovery highs took place during May and July and that time is now running out for the bulls?" My answer is to repeat what I just stated in a preceding paragraph: In a primary bull market time favors the bulls. For this reason, in the current situation the longer the time elapsed without a break below the September-October lows, the better the odds for a resumption of the primary bull trend and an ultimate hurdling of the 1975 recovery highs.

THE PRICE MOVEMENT: A study of the page 1 chart shows a most interesting pattern in the Averages. Primary peaks were recorded by the Transports on May 5 at 174.12, by the Industrials on July 14 at 881.81. The market then reacted, and secondary lows were recorded during September and October, 784.16 for Industrials and 149.38 for Transports.

Following the September-October reaction lows, the market rallied, and secondary highs were struck on October 23. Those highs were 855.16 for Industrials, 168.18 for Transports. A mild decline ensued, followed by a new advance. In early November the Transports pushed above their own secondary peak and headed for the primary peak of 174.12. Industrials, by far the weaker Average, faltered just below the peak of 855.16.

Then came a most interesting move. On November 17 the Transports pushed above their May 5, 1975 high to close at 174.57. This was a new 1975 recovery high. On the same day Industrials hurdled their 855.16 peak of October 23, to close at 856.66, their highest level since July.

Despite the November 17 showing, the price structure is not without its flaws. The main flaw is as follows: The action of November 17 now presents us with the technical problem of a new recovery high on Transports, a high which has not been confirmed by a new 1975 recovery high for Industrials. The overriding question now is whether Industrials will confirm the carriers by advancing above their July 14 peak of 881.81?

I noted in a recent report that this bull market has "something for everyone." Everyone certainly includes the bears. With each upside point, the market has provided food for the pessimists, and the Averages have literally been clawing their way up the "wall of worry." At present, the worries include not only the fundamental (economic) questions but the technical ones — will the Industrials confirm by bettering the 881.81 level?

Again, I'll repeat that I believe the September-October lows represented the lows for this reaction. If so, then regardless of bad news, a shaky NYC, world monetary problems or what have you, the Averages should grind up and over the 1975 highs (and of course, Transports have already done just that).

We have a few helpful guideposts at this time. First, in the majority of cases a penetration of one Average through a preceding point (in the primary direction) has been confirmed by the other Average. This is another way of saying that it is a good policy to give the market the benefit of the doubt on the upside when the primary trend is bullish (and the benefit of the doubt on the downside when the primary trend is bearish). Thus November 17's rally by Transports to a new unconfirmed high could be a harbinger of trouble ahead — but it could also represent the beginning of an Industrial attack on the 1975 high.

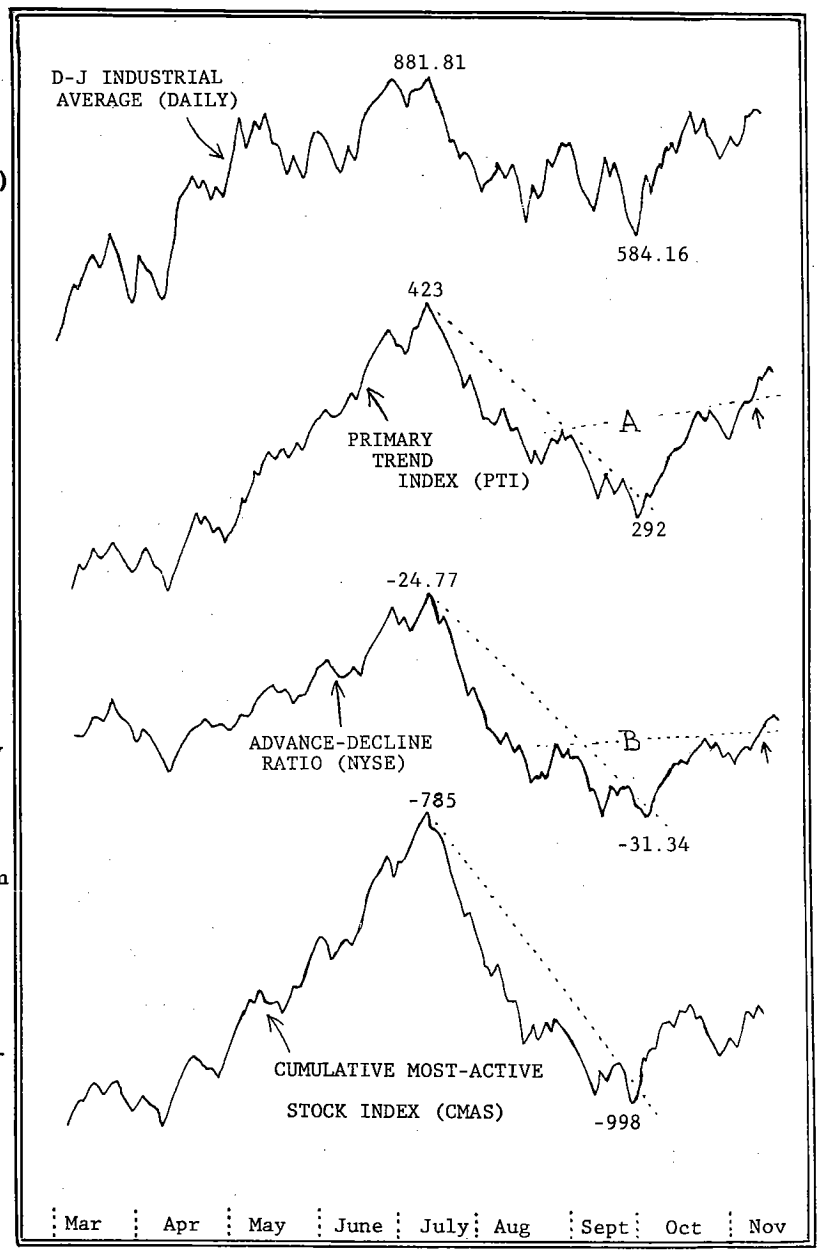
Based on my interpretation of this as a primary bull market, the odds favor an ulitmate upside resolution of the current price structure. The market is now quite "overbought," however, and some retracement may be necessary. I am allowing, as I always do, for sell-offs, shakeouts and nervousness along the way, but the bull is shaking his head and beginning to paw the ground. In time, today's cautiousness and outright pessimism should give way to optimism and finally enthusiasm.

TECHNICAL INDICES: The chart on page 3 portrays the Dow Industrials and three of the most important indicators followed here. The Primary Trend Index (PTI) was discussed in the last report, and attention was directed to the "head-and-shoulders bottom" which appeared to be forming in this composite indicator. On November 13 the PTI broke above the resistance line (A on chart) and this index is now leading the way on the upside.

A few days later the A-D ratio (which traces the advancing or declining tendencies of all NYSE issues) broke above its own resistance level (B on chart). Thus, this indicator has also signalled "strength" in the underlying structure of the market.

Finally, the cumulative most-active stock index (which is an A-D line of the plurality of daily most-active issues on the NYSE) is still flirting with its October peak, and, of course, a push by CMAS above the preceding October high would provide a strong confirmation of the indications of the PTI and A-D ratio.

It goes without saying that the technical "signal" that all Wall Street would like is a Dow Industrial surge above the July 14 high of 881.81. In due time, the market will tell us its story. But remember, Wall Street loves to make its followers sweat. On that account, the Street has been doing a bang-up job since July!



ADVANCE-DECLINE RATIO: Back in Letter 637 (July 25) I presented a study of the long-term or 30-week moving average of the A-D ratio. This important index (chart on page 4) is based on the weekly differentials of advances and declines on the NYSE. The differentials are arranged in the form of a 30-week moving average, so that fluctuations can be smoothed and the trend more easily studied. Figures for the weekly A-D study are contained in many local newspapers (Sunday edition) and in Barron's.

What this index basically deals with is the long-term totals of advances (accumulations) and declines (distributions) plotted above or below a zero line. When the index is above zero (see chart) it means that advances, on an average of the past 30 weeks, have exceeded declines, and when the index is below zero it means that declines, on a 30-week basis, have surpassed advances.

During a primary bull market there is a marked tendency for the long-term A-D index to hold above zero, and during a primary bear market the A-D index tends to remain below zero. The build up of accumulation pressures can be seen as the index climbs above zero and then hurdles preceding tops. The rise in distribution (see chart during 1971 through 1974) can be seen when the index plunges below zero with bottoms breaking below preceding bottoms.

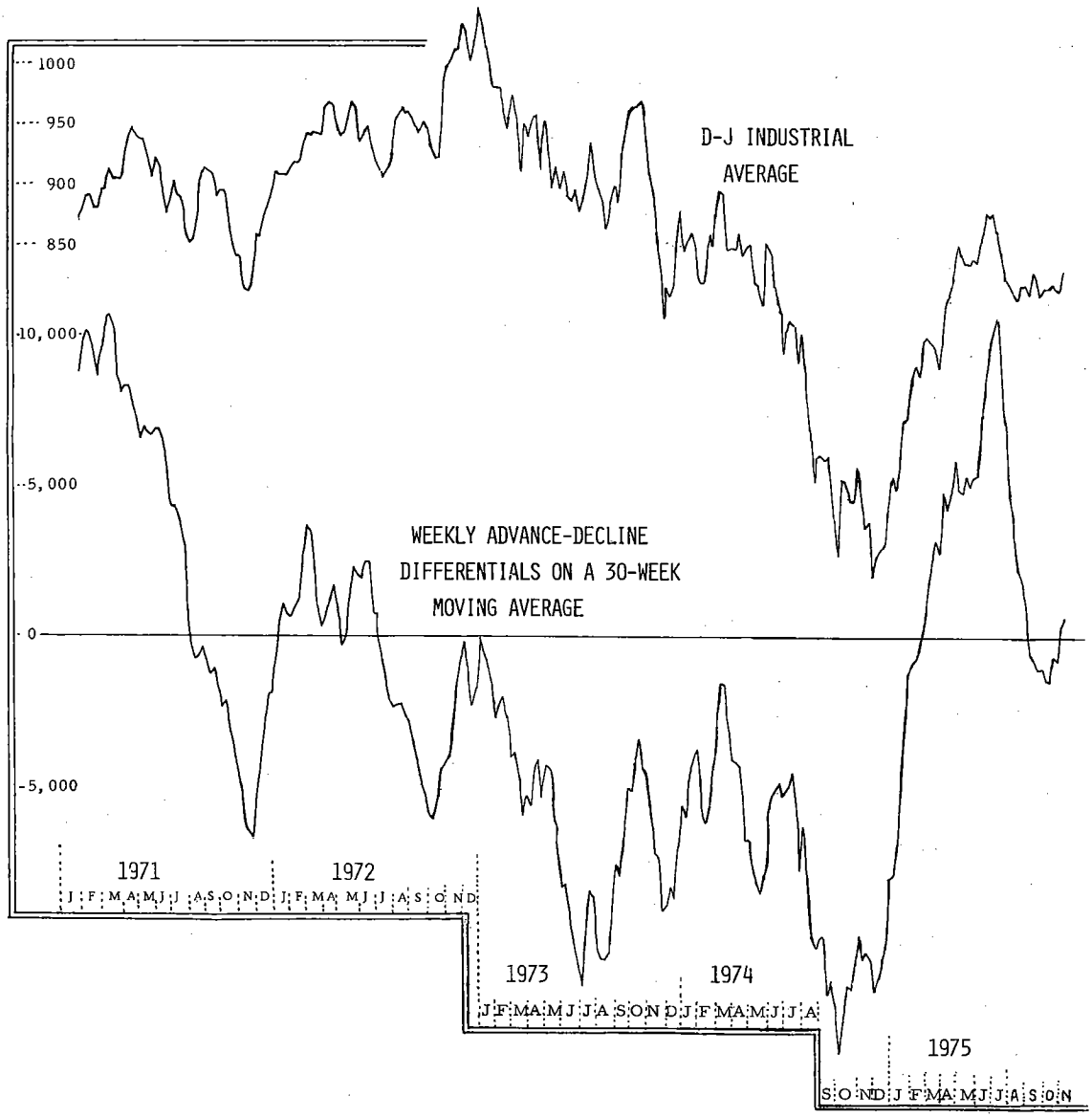
Letter 637 noted that the long-term A-D index was literally crashing during 1973-74. During October of 1974 the A-D index hit an incredible low of minus 14,000. From there it turned up sharply. When the Dow dropped to a new bear market low of 577.60 in December, the A-D index refused to confirm on the downside. What followed was one of the most violent and powerful climbs in the history of the 30-week A-D index.

In January, 1975 the long-term A-D index roared over the zero line, and it continued to climb right into the June period. In June the index registered plus 14,000, thereby swinging into just as overbought a condition as it was oversold at the October low (at minus 14,000).

In Letter 637 I commented upon that situation as follows: "In recouping four years of decline in a period of only nine months, I would say that breadth (the A-D ratio) could be due for a 'big rest' in the form of a downward correction. But is is well to remember that the A-D line has only been above the zero level for five months or since March, 1975, whereas it has been below the zero line ever since mid-1972. So on the big picture, breadth could still (over the next few years) do a lot of catching up on the upside, regardless of temporary reactions."

Studying the chart, you can see that the opinions expressed in Letter 637 have come to pass. The long-term A-D index came down to minus 1600 in September, 1975, or just below the zero line. This, I feel, constitutes a legitimate secondary correction during a bull market. The A-D line turned up again in late-September and as of two weeks ago it has climbed above the zero or "neutral" line again.

My feeling is that the action of the long-term A-D line has been bullish since October of 1974, and it has remained bullish. The action since September, 1974, is constructive and suggests the completion of a downward correction and the resumption of the primary bull trend. The ability of the A-D index to better its June top will measure the intensity of the accumulation from



here. But it is not necessary for a continuing bull market to outdo itself in order for the bullish condition to remain in force. A persistent path by the A-D index above zero (for a period of at least a few months) would be a happy occurrence, and I think that there is a good chance that we will witness just that kind of positive action in the period ahead.

THOUGHTS: I was a motorcycle rider for twenty years, and although I sold my cycles a year ago, I feel that I qualify as some kind of expert on the art of staying alive on "bikes." Part of the art entails knowing why you are riding and what you expect to get out of it. If you ride a motorcycle because a cycle provides cheap transportation or because you like cycle riding as a sport, well, those reasons are perfectly legitimate, and I can't fault you on your motives. In either case, however, I suggest helmets, goggles, leather jackets and defensive riding tactics.

One thing every cycle rider must learn is that when you get into an accident, you are the one who is at fault. It's always your mistake. When two cars collide, the drivers invariably argue the merits of who was right and who was wrong. When a car and a cycle collide, there's seldom an argument for the simple reason that the cycle rider is generally heading for the nearest emergency room. Therefore, my point is that the cyclist is always wrong, and his mistake is in ever allowing himself to be tagged.

There is a kind of cyclist who rides for strictly thrills. I never saw one of this breed who did not ultimately get his thrills — all he could handle. When a cyclist told me that he was riding for kicks, I never rode with him. It reminded me of the old religious adage, "Be careful what you ask for, you just may get it."

How does all this apply to the market? In my experience, I have found that very few investors (or traders) actually know why they are in the market. Most will tell you that they are in stocks (or trading stocks) "to make money." But that's a poor argument since traders usually lose money over any extended period of time. What other reasons are there for people to be in the market? The main reason (in my opinion) that perhaps 85% of the people are in the market is the hope that somehow they will be able to "grab a quick profit."

In actuality, unfortunately, it just does not work that way. Consequently, I usually tell people to (1) study the market carefully before making any moves, (2) realize that the market is always there and that there is no law that says one always has to be in the market, (3) decide whether you are willing to give the market the same thought and study that you give your own business. If you are not willing to do this, I suggest you avoid Wall Street altogether.

One of the great problems which I face in writing these reports is that I write for many thousands of investors in every part of the nation, in every walk of life, and in every monetary strata. Obviously, the fund manager, the millionaire and the neophyte auto salesman are going to have vastly different uses for these reports. And it is an absurdity for me to attempt to give intelligent specific advice to each of them.

Furthermore, I know that each man has a different pyschological make-up, a different stress level, and a different personal attitude towards securities. An investment position which means little to one man may be the cause of another man's insomnia. I take all this into account when I write these Letters, and it is the reason why I cannot and will not give personal advice. I haven't got the time or the talent to play psychiatrist, economist, accountant and tax expert. Furthermore, what pleases me or seems intelligent to me personally, may seem almost an absurdity to the next man (who may be more successful in investing than I am).

My basic purpose and desire in writing these reports is to carry on the Dow Theory tradition as I learned it from Dow, Hamilton, Rhea, and Schaefer, to present my own personal interpretations of the market under Dow Theory, and to tell people what I see and how I think.

A few Letters back I suggested that an intelligent investment "mix" at this time might be one-third of available assets in T-bills or a liquid fund, one-third of assets in closed-end bond funds and the final third in closed-end stock funds. I immediately received calls and letters to the effect that "If you're so bullish, Russell, why don't you say 100% common stocks?" The answer, of course, is a personal one. I personally don't think in terms of 100% in any one thing. But of course if I am correct, if this is indeed a primary bull market (which I believe it is), then the man who puts 100% of his assets in common stocks is going to do far better than the man who arranges his assets according to my theoretical mix. But during reactions or periods of market uncertainty, the man who has 100% of his money in stocks is going to do some sweating and night-walking, and that I studiously avoid if I can.

What's the answer, then? The answer is that there is no all-inclusive answer. I don't care what my subscribers do as long as (1) they act according to their own style and inclination, (2) they are comfortable doing it, and (3) they act in harmony with the primary trend.

After three decades in the markets, I have concluded that as far as I am concerned, no investment is ever worth losing sleep over. Stress is a killer. There is enough stress already in the modern world, and I don't need investments to give me a helping hand towards that great analyst's meeting place in the sky.

I operate on the premise (and I have said this many times before) that during a primary bull market there are at least two good "buy spots" per year. We had one in January, and we had a second during September-October. If you miss a buy spot, it is often better to skip it on the theory that (1) timing is extremely important and a late buying spree can be costly, (2) the market will always be there, and if you miss one opportunity, the market (if you're patient) will provide you with another.

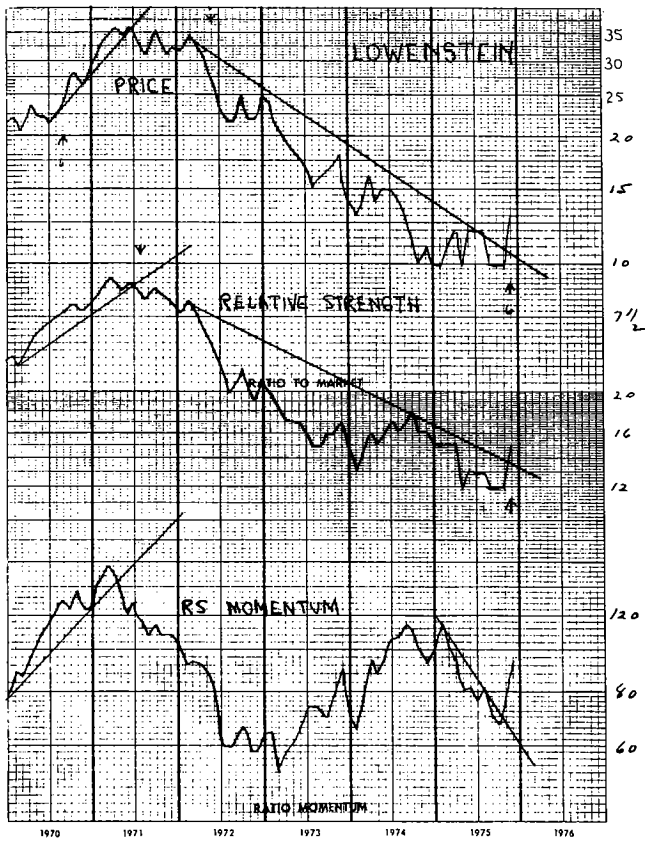
STOCKS: Last week a number of subscribers called (on November 17) to ask if the new Transport high and the Industrials push above the 855.16 level wasn't "a Dow Theory buy signal." They were disappointed when I told them that nothing in Dow's Theory implied buying stocks on an upside penetration. Buy spots according to Dow's Theory are (1) dull areas following important lows in the Averages or (2) areas (after major declines) in which important downside non-confirmations occur in the Averages.

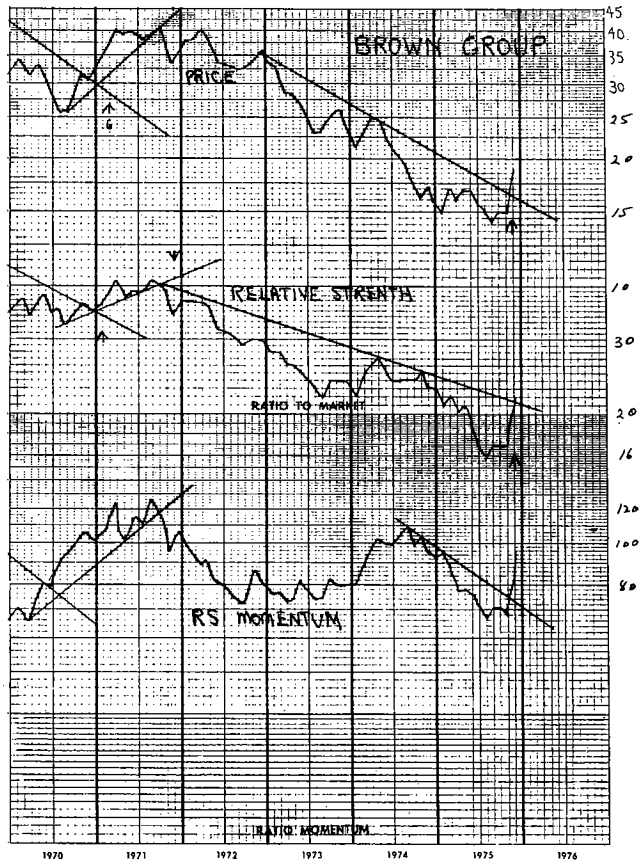
Obviously, the December, 1974 area was a great one for buying, and this was discussed in the "Special" that went out on December 20. We did not wait for an upside breakout at that time, and I wrote that an ultimate bull signal in the Averages would merely mean that our early buying had been correct. In late-January the actual primary bull signal was given.

In Letter 644 (October 8) with the Dow still below 800 I wrote that "I feel there is an excellent chance that the market has bottomed," and I suggested buying stocks at that time. This was the safest period for buying, and it has little to do with any upside breakouts from higher levels.

As I write this, the Dow is 50 points higher and the market is rather overbought. We will probably have to back down some from the 856 Dow level, and this will undoubtedly (1) remove the overbought situation, and (2) scare the devil out of everyone (actually, I sense that stockholders are sitting on the edge of their seats during each and every market session).

In the last Letter I included a chart showing some of the stock groups which are currently outperforming the market on a relative strength (RS) basis. Many RS trends last from two to four years, and it is imperative in investing to stay with the groups that are tending to act better than the market. Stock in these groups will usually do better than the market during general market rallying phases, and hold up better than the leading averages during broad declines.





The outstanding fact about the whole market, from the relative strength standpoint, is that strength is now moving into the consumer oriented groups and out of many of the basic industry groups. Thus, the steel and oil groups are now turning weak on an RS basis and should generally be avoided in favor of say the textile or auto parts groups.

Currently, outstanding consumer groups include Autos, Soft Drinks, Packaged Foods, Leisure Time, Publishing, Department Stores, Shoes, Textiles (apparel and manufacturing), Tire & Rubber, and Trucking. I have recently mentioned a number of individual stocks which are currently looking outstanding from the RS standpoint and these include Brown Group, Quaker Oats, Lowenstein, Macy's. Three Utility stocks which are now outperforming in RS are Virginia Electric, Southern Co., and Public Service Electric & Gas.

By way of illustration I include two of the excellent RS charts put out by Ray*Signals, 43 Lake Ave., Montrose, PA 18801. These are monthly charts showing price, RS and finally RS on a six month change basis (the latter shows whether RS itself is improving or deteriorating). Note that in both Brown Group (shoes) and Lowenstein (textiles) we have reversals of declining trends in both price and RS. Both of these reversals have come following a period of at least five years of declining action. That means to me that these stocks are sold out and now in strong hands. I have been recommending both stocks for months, but the trends appear to have a long way to go.

GOLD: Bullion has been flirting with its downtrending momentum line (see Letter 646, page 5). Just when it appeared that momentum might reverse to the upside (following its long slide), the bullion price weakened again.

My point & figure chart of gold tells the story about as well as anything does. Last week we received the first bearish signal on gold bullion since the 1975 low. This bearish signal occurred when bullion hit a London fix of 142. A second bearish signal would be given if gold (first or second London fix) touches 137. It would require a value of 147 to turn bullion bullish again, and it would require a straight-up move to 157 to penetrate the steeper or secondary downtrend line for gold.

Just as it is fruitless to speculate on the extent or duration of a primary bull movement, it is a pointless exercise to have preconceived notions regarding the extent or duration of a primary bear market. This was my thinking when I told subscribers (last year) that the correct course of action was to scale back on gold holdings, and it was my thinking (as it became apparent early this year that gold was in a primary bear market) when I told people to clean out most of their gold and gold shares. The fact is that we don't know how far this bear market in gold will carry. We don't know whether gold bullion will form a double-bottom at 128-129 or whether it will smash the recent low and go down to 100 or lower. We just do not know!

The gold shares are being sold heavily, perhaps due to the new French "agreement" regarding cooperation in stabilizing the dollar. Since France was in the forefront of the anti-American, anti-dollar, pro-gold forces, any agreement between the US and France is not calculated to be bullish for gold. On top of this, we have the gold shares being subjected to the squeeze of lower bullion prices and higher wages, and we have the year-end tax selling which should be a depressant on the shares for the next month or so.
Next mailing: December 3.